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Akhuwat: Potential for a Sustainable Islamic Interest Free Microfinance Model

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AKHUWAT: POTENTIAL FOR A SUSTAINABLE ISLAMIC INTEREST FREE MICROFINANCE MODEL

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Abstract: *This study will examine if Akhuwat provides a sustainable Islamic interest-free Microfinance model for potential poverty alleviation. This question is particularly complicated for an organization that relies so heavily on subsidies. Theoretical debates of sustainability and the recognition of donations, cross-market comparisons, and data from audit reports will validate Akhuwat's potential for long term sustainability. Analysis also highlights the discrepancies that plague this opaque industry.*

I. Introduction

This study will take a closer look at Akhuwat, an innovative Islamic Microfinance Institution (MFI) in Pakistan, in order to gain more insight into whether it provides a sustainable model for potential poverty alleviation. An estimated 72 percent of people living in Muslim-majority countries do not use formal financial services (Honohon 2007). With high poverty rates in the Muslim world, microfinance has potential to play a key role in providing financial access to the poor. However, conventional microfinance institutions tend to provide products that are incompatible with the financial pillars of sharia law within Islam. Most notably, sharia law disallows the use of interest-bearing loans. Surveys conducted in Jordan, Algeria, and Syria revealed that 20-40 percent of respondents cite religious reasons for not accessing conventional microloans (Consultative Group to Assist the Poor[1]). Despite the high poverty rates in Muslim-majority countries and incredible market potential, sharia-compliant microfinance represents less than 1 percent of the Microfinance industry (CGAP). While conventional microfinance has grown tremendously in the past decade, Islamic microfinance growth has been slow in comparison (CGAP). Nevertheless, Islamic microfinance is a budding industry still in its infancy, with the number of service providers offering sharia-compliant microfinance products doubling since 2006 (CGAP).

Pakistan is considered a promising market for Islamic Microfinance, with 98% of the 180 million population being Muslim and a strong cultural focus on a just economic system (Haider 2012). Following trends in Indonesia, Bangladesh, and Malaysia, the

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[1] Henceforth "CGAP"

[2] This means that Akhuwat charges no interest on any of their services. This is different

State Bank of Pakistan stepped up in 2007 to create Islamic microfinance guidelines and promote growth of Islamic MFIs. This study will focus on Akhuwat, one of the first fully Islamic MFIs in Pakistan. To gain insight on Akhuwat's relative success, this study will use sustainability and efficiency indicators to make comparisons between Akhuwat and The Wasil Foundation (Wasil), another interest-free MFI. These organizations' performance will also be compared to nationwide and region wide industry averages. Comparisons intend to shed light on the potential sustainability of Akhuwat, and gain further insight on why the Islamic Microfinance sector has yet to take off in the Muslim world.

Akhuwat is based largely on charitable funding, with their primary product being "Qarz-e-Hasan" (an interest free loan with long repayment periods). Akhuwat, which means "brotherhood," is unique in that its model is developed on the concept of community and most branches have been set up in mosques and churches (Haider 2012). Because Akhuwat has no profit margin on their loans, the institution relies heavily on donations and subsidies, which may have the potential to hamper sustainability in the long run. In contrast, the Wasil Foundation offers a range of products that have a profit margin and thus does not offer "Qarz-e-Hasan" loans. Their focus remains on enterprise as opposed to social values.

In addition to making cross-market comparisons, this study will examine the theoretical debate behind defining sustainability and will take a closer look at Akhuwat's audits. Discussion and results will call attention to the issues of sustainability faced by largely subsidized programs. Data analysis will highlight discrepancies in financial indicators provided by Mix Market Database, Audits, and scholarly research, validating the heavy criticism of the opaque nature of the industry. Finally, the study will identify potential for infrastructural change in Pakistan to facilitate the success of Akhuwat. Findings have the potential to provide valuable insight for other Islamic MFIs that are still in their embryonic stages but have great potential to catch up to their conventional counterparts.

II. Literature Review

Recent research has shed a controversial light on microfinance. Since the industry's infancy in the 1970's, many have deemed microfinance as the most promising answer to poverty. The most recent studies, however, argue that this is not necessarily the case and that the industry is plagued with inconclusive data and opaque results. Banerjee and Duflo (2013) studied the impact of microfinance in a randomized evaluation taken from the slums of Hyderabad, India. They found that while microcredit did impact household consumption and helped create businesses, there was no detectable effect on education, health, or women's empowerment. Their conclusions are representative of the majority of recent literature, but they do add that it may take more time for the microfinance sector to cause noticeable change to these major macro indicators. The overall impact of microfinance, however, is too complex for the scope of this paper.

A 2012 report from the Centre of the Study of Financial Innovation (CSFI) found that client over-indebtedness is the most concerning risk in the microfinance industry. The report speculates that this may point to wider issues in the sector, raising questions about the increasing emphasis on growth and profit of MFIs. It is from this logic that many researchers propose giving to the poor instead of lending to the poor. Initial research on Conditional Cash Transfers (CCT) proves promising. Rawlings, Laura (2005) claims that there is “clear evidence of success from the first generation of programs in Colombia, Mexico, and Nicaragua in increasing enrollment rates, improving preventive health care, and raising household consumption.” A study by Kabeer and Waddington (2015), published in the Journal of Development Effectiveness, randomly evaluated 46 quasi-experimental impact evaluations of CCT. They found that CCT programs decreased child labor, increased household consumption and investment, and smoothed consumption. Appraisal for non-profit models of financing the poor bodes well for Islamic microfinance, which prides itself on social justice and wealth redistribution.

While there is an abundance of research on microfinance, Islamic microfinance is relatively unchartered territory. Islamic microfinance has been coined as an “emerging market niche” by CGAP. A 2007 CGAP survey collected information from over 126 Islamic MFIs and revealed that Islamic MFIs have a total global outreach of 380,000 clients, making up only one half percent of the total microfinance outreach. Furthermore, the report found that 80% of the global outreach is concentrated in only three countries: Indonesia, Bangladesh, and Afghanistan.

Kazim, Syeda and Haider Syed (2012) researched the viability of Islamic microfinance in Pakistan. They conclude that there is great need for financial services in Pakistan, and that Sharia compliance is oftentimes seen as a necessity before using financial services. The study provides a breakdown of the viability of two models of Islamic Microfinance, one of which is essentially already being implemented by the Islamic MFI Akhuwat. This model is based on the concept of “Waqf,” meaning the dedication of a resource in the way of God. Waqf resources can be used only for charitable purposes, and the charitable investment must be self-perpetuating, like lending money to a poor person so they can learn a skill or start a business. According to the report, a Waqf-based microfinance is one of two viable Islamic Microfinance models for Pakistan. It allows Islamic MFIs to grant "Qarz-e-Hasan" loans, meaning without interest, and thus expand in scale and increase outreach by gaining geographical coverage. However, they note that Waqf is not a sustainable source of funds as it relies on community benevolence and no current legal framework exists that redirects funds collected by Waqf-based non-profit organizations to Islamic MFIs. Furthermore, the report points out that existing regulations do not allow organizations like Akhuwat to mobilize savings as a source of self-funding. The authors propose that these organizations attempt to receive patronage from charitable organizations in Pakistan, while admitting this may be a tedious process.

Muhammad Naveed (2014) draws evidence from the Islamic Microfinance network already in place in Pakistan and concludes that Islamic microfinance is "playing an important role improving the living standard, per capita income, awareness level, ethical values, profitability, infrastructure position, and employment level in the society" as well as improving unequal distribution of wealth. Farooq and Khan (2014) compiled data on the social and financial performance of two Islamic and two conventional MFIs in Pakistan, all rated with four stars by Mix Market database. The article pulled information on productivity, profitability, portfolio quality, social indicators and financial structure of each organization from 2005 through 2010. These are commonly used measurements in microfinance studies, specifically studies comparing the performance of conventional versus Islamic microfinance. They found that Islamic MFIs were more cost effective, based on “Cost Per Borrower” and “Operating Expenses to Assets.” Akhuwat had the most efficient employees, followed by a conventional MFI. The conventional MFIs beat out the Islamic MFIs in financial efficiency, with a higher ratio of “Financial Revenue to Assets.” The study found mixed results for financial performance based on portfolio quality and profitability indicators. While the report found no source of concern regarding portfolio quality across all four MFIs, profitability indicators were not promising. Asasah, a conventional MFI, was the only organization that showed a positive return on equity. It is important to note that there was missing data for several of the years observed. Further, data from Mix Market is self-reported and thus discrepancies and errors are likely.

There is still plenty of research to be done on the viability of Islamic Microfinance. As of now, there are few studies that incorporate accurate and up to date qualitative or quantitative client data from Pakistani Islamic institutions such as Akhuwat and The Wasil Foundation. Information from Mix Market and audits, as well as up to data information from Akhuwat Headquarters, will provide original and valuable insight on the sustainability of the organization.

III. Akhuwat: A Closer Look

To understand the mechanics of Akhuwat it is important to identify the founding principles of the organization. Akhuwat is one of only a few institutions in Pakistan that offers a fully sharia-compliant product line. [2]Islamic scholars believe that interest, or "riba", is inherently exploitative and that money should be used purely a mean of transferring funds and has no intrinsic value. Thus, it is unlawful to make a profit off of money itself. Akhuwat, still in its infancy, has offered a fully sharia-compliant product line since 2001. Their vision is to create "a poverty free society built on principles of compassion and equity" (Akhuwat). Dr. Saqib, the founder of Akhuwat, explains that the interest-free loans of Akhuwat ensure that the hard work of borrowers does not go to waste (Saqib 2012). Akhuwat's perspective on interest is described on their website:

> *In addition to ideological reasons, high interest rates may contribute to exacerbating the plight of the poor as recent global evidence has demonstrated. For Akhuwat, by using money to earn money, not only does wealth remain concentrated in the hands of a few but the direction of financial flows remains from those who have little to those who have more. In keeping with the principles of equity and social justice, burdening the poor with exorbitant interest rates is also viewed as undermining the overarching goal of poverty alleviation.*

In following this charitable ideology, Akhuwat maintains a portfolio that is 90 percent "Family Enterprise Loans" in the form of "Qarz-e-Hasan" (interest-free loans that are derived from the teachings of Islam). These loans are eligible to any individual who has come up with a viable business plan. This lending model will be discussed in further detail later on in the paper. The remaining 10 percent of the loan portfolio include education, health, housing, liberation and emergency loans.

Akhuwat's alignment with Islamic principles extends beyond the interest free loan mechanism. Akhuwat's linkage with religious space is something that sets the institution apart from its counterparts. Both loan introduction programs and loan disbursements are conducted at mosques or churches to raise awareness in poor localities. This also

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[2] This means that Akhuwat charges no interest on any of their services. This is different than a conventional MFI that offers some products interest free.

increases transparency and accountability while taking advantage of underutilized space and cutting down on overhead operating costs. While the organization is founded on Islamic ideals, supposedly no individual is discriminated on the basis of religion or gender.

In keeping with Akhuwat's religious philosophical commitment, a central pillar of the organization is that "it is essential to look beyond oneself." Founder Dr. Saqib expects today's borrowers to become tomorrows' lenders- he says to "pay back a good deed is better than a good dead" (Saqib 2012). Akhuwat's success converting borrowers to donors is another key aspect that distinguishes it from other institutions of its kind. The growth in donations Akhuwat has received since initiating its Member Donor Program (MDP) in 2008 is nothing short of a phenomenon.

TABLE 1: MEMBERSHIP DONOR PROGRAM[3]

Year	**Donations from Borrowers (US Dollars)**	**Annual Growth Rate**	**Donations from Borrowers as % of Total Expenditure[4]**
2008	$314	**NA**	**NA**
2009	$157	**(50)**	**NA**
2010	$92,568	**59078**	**35%**
2011	$185,779	**101***	**31%**
2012	$361,762	**95***	**36%**
2013	$819,753	**127**	**39%**
2014	$1,401,535	**71**	**38%**

[3] Donation numbers are received from Akhuwat headquarters directly. Starred numbers are different than the growth rate reported by the Islamic Financial Report, likely due to error.

[4] Ratios start at 2010 because this is when donations reach significant numbers.

The numbers in Table 1 have been converted from Pakistani Rupee to US Dollar using the approximate exchange rate of USD/PKR 105.4[5]. From 2008 to 2014, donations accumulated from borrowers increased from $314 to $1,401,535 dollars. From 2009 to 2010, donations from borrowers increased a staggering 5,9078%.[6] Since then, growth rate of donations declined, but have maintained relatively stable, reaching 71% as of 2014. According to Dr. Saqib, the founder of Akhuwat, from 2011-2013, donations from borrowers alone covered around one third of Akhuwat's operating expenses. These ex-borrower voluntary contributions not only bode well for long-term sustainability, but also are indicative of a certain level of efficiency of the program, as the ex-borrower is financially stable enough to make a donation.

Dr. Saqib claimed in 2010 that with the enormous help of donations from borrowers, Akhuwat was 60% percent operationally self sufficient and with hopes of ultimately being "operationally self-sufficient." He tells the Berkeley Center for Religion, Peace, and World Affairs: "The way the program is progressing, we believe that in few years, the entire operational cost will be matched by donations given by the borrowers, and we will be operationally self-sufficient." Further, Akhuwat's newsletter states that, despite being voluntary, "the Member Donor Program (MDP) has raised around 13 million rupees since 2008, and Akhuwat continues to receive large sums of money from this source in the form of small donations of Rs. 1-3 per day. The MDP currently covers part of Akhuwat's operational expenses. And, given the momentum with

[5] The USD/PKR exchange rate has since fluctuated to 103.5. However, to maintain consistency, the 105.4 rate is used throughout this study to present all numbers in Dollars.
[6] Further research is necessary to understand why this number is so large. It may likely be the result of a successful marketing campaign by Akhuwat.

which it is growing, MDP alone could make the organization self-sustainable in the foreseeable future." While sounding promising, this is a problematic statement in that the formulaic interpretation of operational self-sufficiency (OSS) does not include donations in revenue, and thus these donations would not help Akhuwat move towards a higher OSS percentage. Mix Market, the SEEP Network, the World Bank, and CGAP all exclude donations and subsidies from operational income, the numerator of the OSS ratio. According to Mix Market, in 2011Akhuwat was 18.74% operationally self-sufficient. However, this ratio shot up to 99% the following year. It is important to keep in mind that these numbers are voluntarily self reported, and that this massive increase is either likely due to an error or a change in accounting practices with regard to donations. Akhuwat also reported higher operational expenses and lower revenue on Mix Market than other studies have suggested. Clarifying these discrepancies will be integral in addressing Akhuwat's sustainability.

IV. Defining Sustainability

In order to investigate Akhuwat's sustainability, we will first review the prevailing accounting methods used for calculating important sustainability indicators. CGAP guidelines state that MFIs should operate without subsidies, relying on private investment instead. Similarly, "The New Microfinance Handbook," by Joanna Ledgerwood, advocates that funds donated to cover operating costs (subsidies) should be deducted from net income prior to financial performance analysis, as they do not represent revenue from operations (Ledgerwood 2014). This ensures that financial statements reflect the true level of expenses that would be incurred if the MFI were to operate without any in-kind donations. These guidelines are penalizing to Akhuwat because they rely on subsidies such as the free office space of their mosque distribution centers and the volunteerism of their employees (who, on average, volunteer about 20 percent of their time) (Munir 2012). CGAP's emphasis on non-subsidized sustainability is evident in the following Financial Self-Sufficiency (FSS) formula frequently used in comparing MFIs:

$$\text{FSS} = \frac{\text{Business Revenue (Excluding grants and extraordinary items)}}{\text{Total Expenses} + \text{CFA} + \text{ISA} + \text{IA}}$$

In the above formula, CFA refers to Costs of Funds adjustment, ISA refers to In-kind Subsidy Adjustment, and IA refers to Inflation Adjustment. As shown in the formula, goods and services purchased at a subsidized rate are added onto expenses, and thus firms are penalized for receiving grants and subsidies. Additionally, grants are not included in business revenue. FSS is adjusted to account for subsides and grants so that it can provide a fair cross-comparison between the financial health of MFIs that receive subsidies and those that do not. Because this paper approaches sustainability from a welfarist perspective, and this formula is particularly penalizing for subsidized firms, we will instead focus on another frequently used indicator, Operational Self-Sufficiency (OSS):

$$\text{OSS} = \frac{\text{Operating Revenue}}{\text{(Financial expense + Loan-loss provision expense + Operating expense)}}$$

In this case, operating revenue[7] does not include donations or "any revenue that is not generated from an MFI's core business of making loans and providing financial services." It does, however, include financial revenue from loan portfolio. Financial revenue from a loan portfolio is defined as "revenue from interest earned, fees, and commissions (including late fees and penalties) on the gross loan portfolio only." In the case of Akhuwat, operating revenue excludes a substantial portion of funding which they receive from donors. Considering Akhuwat's key philosophy and strategy is to convert borrowers to lenders, then perhaps these donations should be classified as a source of revenue received from their institutional efforts and loan portfolio. If one is to consider these donations a source of revenue, then this formula is underestimating Akhuwat's operating revenue and thus the calculated OSS may not be an accurate reflection of the institutions sustainability.

Another formula that subsidized MFIs will systematically underperform in is return on assets. According to CGAP, Return on Assets (ROA) also does not include donations.

$$\text{ROA} = \frac{\text{(Net operating income-taxes)}}{\text{Average assets}}$$

In order to merit high scores from this formula, as well as the OSS and FSS formulas, institutions need to charge interest rates that cover a substantial proportion of operating

[7] Also referred to as operating income.

costs. Keep in mind that donations of any kind are not included in net operating income. Again, this is a substantial penalization for a firm such as Akhuwat that receives a significant chunk of funding from its own borrowers. Based on the basic accounting definition, assets are "resources owned by a company and which have future economic value that can be measured and can be expressed in dollars." Canada Non-Profit Accounting (CICA) guidelines state that "a contribution receivable should be recognized as an asset when it meets the following criteria: (a) the amount to be received can be reasonably estimated; and (b) ultimate collection is reasonably assured." It is without question that the loans made by Akhuwat to borrowers are assets, even though the situation is unique in that there is no return of interest. What is more arbitrary is what we may include in the return on these assets. While it is clear that in the case of Akhuwat, the processing and service fee will be recognized as return, what about the voluntary contributions that are received directly from borrowers in appreciation of these loans?

Scholars have recognized the unique accounting situation of the ex-borrower donations of Akhuwat. Benedetto and Bengo (2014) write: "…from a technical point of view, ex-borrower donations can be considered as voluntary loan repayments not in terms of principal costs, already repaid, but of additional delivering costs to membership fees." This statement categorizes ex-borrower donations as essentially add-ons to membership fees, thus giving validity to its recognition as return. This logic sheds light on the controversial debate on whether or not donations should be included in revenue. While there is theoretical framework to support the notion that voluntary contributions should count as revenue, there also exists a school of thought that takes the opposite stance.

Hence we are confronted with the infamous "Microfinance Schism" of institutionists versus welfarists.

The formulas defined by CGAP, Mix Market and SEEP Network generally align with the "institutionist" perspective on MFIs, which argues that MFIs can never attain sustainability while receiving such a large chunk of their funding from donors and subsidies. However, it is important to note that there are two distinct schools of thought on how donations should be treated in the financial assessment of an organization. We will take a closer look at both of these perspectives.

Woller (1999) writes "Implied by institutionists is that subsidized MFIs are inherently inefficient in that the absence of profit motive fails to create the proper incentives for management." Institutionists believe that MFIs should charge interest rates that cover their costs, and that the working poor can afford to pay these interest rates (Robinson 1996). Further, because targeting the poor and providing small loans induces higher costs, these interest rates tend to be very high (Conning 1999). The concept that the very poor can afford the high interest rates of fast growing and financial self-sustaining MFIs has proven questionable over the past decade. The most recent assessments of microfinance have shown that client-indebtedness is one of the biggest problems facing the industry (Centre for the Study of Financial Innovation[8] 2012). It seems that the poor cannot afford the high interest rates that allow MFIs to remain self-sufficient. Furthermore, institutionists believe that subsidized programs will fail before they reach significant numbers, and thus few low-income entrepreneurs will end up benefiting from these programs. This perspective is hard to reconcile with the MFI

[8] Henceforth "CSFI"

experience of the heavily subsidized Grameen Bank as well as the growing client base of Akhuwat.

On the other hand, "welfarists" argue that MFIs can achieve sustainability without achieving financial self-sufficiency in its traditional sense (Morduch 2000). They argue that donations are a form of equity and that donors are "social investors." These investors receive the intrinsic return of not investing in firms they find offensive and instead investing in firms that will maximize their desired social impact (Brau 2004). While institutionalists believe that organizations "cannot rely on government or donors as reliable sources of subsidized funding", welfarists believe that donors are no more rational or irrational than any other economic actor and the concern for poverty alleviation will never dry up. Further, welfarists criticize the rapid growth of profit seeking organizations as contradictory to poverty alleviation. In the case of Akhuwat, dependence on local donors means it is not under pressure to scale-up quickly (Munir 2012).

Welfarists propose a new definition of sustainability that bodes well for organizations such as Akhuwat. Breaking away from tradition, they define sustainability as the ability to produce outputs that are valued sufficiently by beneficiaries and other stakeholders so that the program receives enough resources and outputs to continue production" (Woller 1999). For example, a government will likely act as a rational donor in that it will not abandon a subsidized MFI if it provides more bang for the buck than other social investments. Woller introduces the concept of a "social investor" and redefines the meaning of "subsidy" so that a donor-funded MFI achieving significant outreach and impact, where its social benefits exceed the alternative social investments should not be considered "subsidized." Thus, an MFI can be viable in the long term despite donor funding reliance. Under these terms, Akhuwat has potential to be considered a sustainable and successful institution. This paper will test the welfarist hypothesis while assessing the sustainability of Akhuwat using financial analysis as well as qualitative and quantitative client data. Results will deter Akhuwat from striving to become subsidy-free, as institutionists theory would encourage.

A challenge to keep in mind is that improved social welfare is inherently costly to measure. And, although as welfarists suggest donors are no more or less rational than any other economic actor, it would be naïve to assume that they can accurately asses the impact of their contributions. Traditional microeconomic theory suggests that rational consumers determine social benefit and will only purchase a product with net economic gain. However, behavioral economics tells us people are not rational; there are many ways that they can be fooled into thinking that the social benefit is bigger than the private cost of a donation when, in fact, it may not be. So, the important things to consider are if a donor is any less accurately able to assess the social impact of their donation than any other economic actor is able to assess the payout of his or her investment, such as a venture capitalist. Additionally, even if the consumer cannot accurately predict the social benefit of his or her investment, as long as the institution successfully convinces him or her that the social benefit is higher than the private cost, then they will continue to invest. The consumer's decision to reinvest will signal a positive return on (a more abstract definition of) equity. According to the Stanford Social Innovation Center, Akhuwat's model is groundbreaking in that it challenges deeply entrenched assumptions about economic behavior. Many borrowers will pay back Akhuwat before their other interest-bearing loans. Being able to pay Akhuwat back in full (as opposed to difficult-to-pay back interest-bearing loans) instills in the borrower a strong self-esteem that encourages funding another lender. It also likely brings social recognition to the ex-borrower. Malcolm Harper, a scholar on enterprise development, writes:

> *Akhuwat's expansion depends on continuing donations to finance growth in the loan portfolio, and on the continued willingness of the voluntary staff. There is as yet no evidence that these will stop, and although substantial effort has to be put into fund raising, and further initiatives will be required in future, there does not seem to be any reason why a programme which depends on brotherhood, generosity and goodwill should be any less 'sustainable' than one which depends on purely financial incentives.*

Joseph Morduch, Associate Professor in the Department of Economics at Harvard backs this opinion:

> *"Since donors and governments remain committed to poverty alleviation as a top priority, advocates are not unreasonable in arguing for allocating some poverty-alleviation funds to support innovative and effective microfinance programs over the long-term. How this will play out exactly is a matter of speculation, but there is no reason to think that concern with poverty alleviation will quickly whither. Nor is there reason to think that support for subsidized microfinance programs will whither -- as long as they remain vigilant in containing costs and maximizing outreach." (Morduch, 2000)*

Complimentary to Morduch's recommendations of remaining vigilant in containing costs, it is not profit maximization that makes a program efficient, but having a hard budget constraint, which is possible even with subsidies. A hard budget constraint means that even if the firm tries hard to cut its losses, the environment will not tolerate a protracted deficit (Kornai 1986). Take, for example, a soft budget constraint where performance criteria are not carefully specified and managers can expect to be bailed out after poor performances. Containing costs will not be a priority, as managers do not face severe consequences of failures to do so (Morduch 2000). With a hard budget constraint, a deficit causes fear because it may lead to extremely serious consequences. Kornai distinguishes between the goals and the hardness of the budget constraint by arguing "hardness of the budget constraint is not a synonym for profit maximization…profit maximization refers to the internal goal setting of the decision maker of the firm: the softness-hardness of the budget constraint refers to the external tolerance-limits to losses" (Kornai 1986). For Akhuwat, maintaining a hard budget constraint means behaving in an entrepreneurial manner and adjusting to unfavorable external circumstances by improving the mechanics of the organization if necessary (i.e. cutting costs, introducing new products or programs) (Kornai 1986). The firm should be held accountable to a certain level of efficiency before being given subsidized funds from private and public entities. As a heavily subsidized organization, Akhuwat should abide by certain theoretical efficiency principals. While Akhuwat prides itself on low operating costs, a comparison in the following section of operating costs between Akhuwat and the median of aggregated MFIs in Pakistan as well as the in South Asia reveals that operating costs are relatively high.

Another important mechanism for achieving efficiency in subsidized programs is to use socially-determined transfer prices and be rigid in evaluating performance according to those prices (Morduch 2000). While microcredit managers may not be able to lend at an actual profit, they could be lending with a net social gain. Morduch (2000) explains how institutions can lend at a net social gain without making a profit. The concept is based on the distinction between "transfer prices" and "shadow prices." While transfer prices are internal prices that value capital and can be utilized to compare in house performance, shadow prices are adjusted downward to account for the social gains produced by lending.[9] In the case of Akhuwat, revenue should be tied to performance based on shadow profits. However, shadow prices can be arbitrary. The social gain from an interest free loan is likely, to some degree, intangible. In practice, individual evaluators and researchers select their own shadow prices, making results problematic to compare (Tuan 2008).

As Morduch (2000) explains, the "win-win" proposition suggested by institutionists where MFIs can simultaneously follow the principles of good banking while also successfully alleviating poverty has not proven true. In contrast, achieving financial sustainability in its traditional sense (without the help of subsidies) does not ensure that an MFI can achieve greater scale and outreach. Likewise, subsidized credit programs, contrary to prevailing thought, can be efficient and are not bound to fail.

IV. Cross-Market Comparisons

This section will analyze various efficiency and sustainability indicators in order to compare Akhuwat to The Wasil Foundation (Wasil). This will include comparing the operating expenses, active borrowers, cost per borrower, and write-off ratios of both Akhuwat and Wasil, as well as nationwide and region wide averages. Both organizations are fully Islamic MFIs that operate on very different models, and thus analysis will provide insight on Akhuwat's relative performance.

[9] Shadow prices are dollar values that are attached to each of the short and long-term outcomes that a social program may affect. They are typically used in cost-benefit analysis. In this case, capital costs, not the service price, would be adjusted downwards.

First we will highlight the key differences in lending methodology of the two organizations. While Islamic microfinance consists of a range of services, Akhuwat relies purely on the notion of benevolent lending and thus their portfolio is simple in that it consists mostly of Qarz-e-Hassan loans. Akhuwat charges a small service fee of 100 Rupees upfront (around 94 cents), regardless of the size of the loan. They do not expect this to cover their expenses. Akhuwat receives interest-free loans from government organizations that go into their credit pool and subsidize their costs. For example, the Government of Punjab provided loans to Akhuwat in 2012 and also agreed to subsidize all operational costs of the project that their loans were intended for.

The Wasil Foundation, on the other hand, has a more diverse portfolio that provides services on a partnership basis (Musharakah & Mudarabah), on a trade basis (Murabaha & Salam) and on a rental basis (Ijarah) (Khan 2010). The latter (Ijarah) is a system where Wasil rents agricultural land and then subleases it to a farmer for an agreed period of time. The farmers then pay a monthly rental fee in cash or in the form of crops, depending on the food. These agricultural packages represent about 10% of Wasil's portfolio (CGAP 2014). Wasil has also been acclaimed for its "Salam" agricultural products (CGAP 2014). Salam offers agricultural clients a cash advance against a guaranteed purchase price for their crops. Accordingly, Wasil maintains a large portion of the agricultural sector of Pakistan, while Akhuwat has focused on penetrating urban areas. Traditional economic theory would predict that Wasil will consistently outperform Akhuwat on the basis of its much more diverse portfolio with broader opportunities for financial returns on its assets (loans). However, cross comparisons shown below indicate otherwise.

A comparison of various indicators of Akhuwat and Wasil Foundation provides further insight into the operating schemes of these two different models of Islamic microfinance. Data is taken from Mix Market, which relies on voluntarily contributed information from over 2,000 Microfinance Institutions around the world. For the purpose of this comparison, we will use data from the year 2011, as it is the most current year with available information on both organizations. We will also include the median of an aggregated 27 MFIs in Pakistan for the year 2011, as well as an aggregated median of 250 MFIs in South Asia in 2011. Comparisons between Islamic and Conventional MFIs can be problematic. This is because comparing the risk-sharing products such as Musharaka (which is more like an equity investment product) against a conventional debt-bearing loan is like comparing apples-to-oranges (El-Zoghbi 2015). Having said that, the Qard-e-Hassan loans typical of Akhuwat are also debt instruments, thus making a comparison of Akhuwat to the median Pakistan and South Asian MFI not as problematic as comparing Wasil to either of the three mentioned.

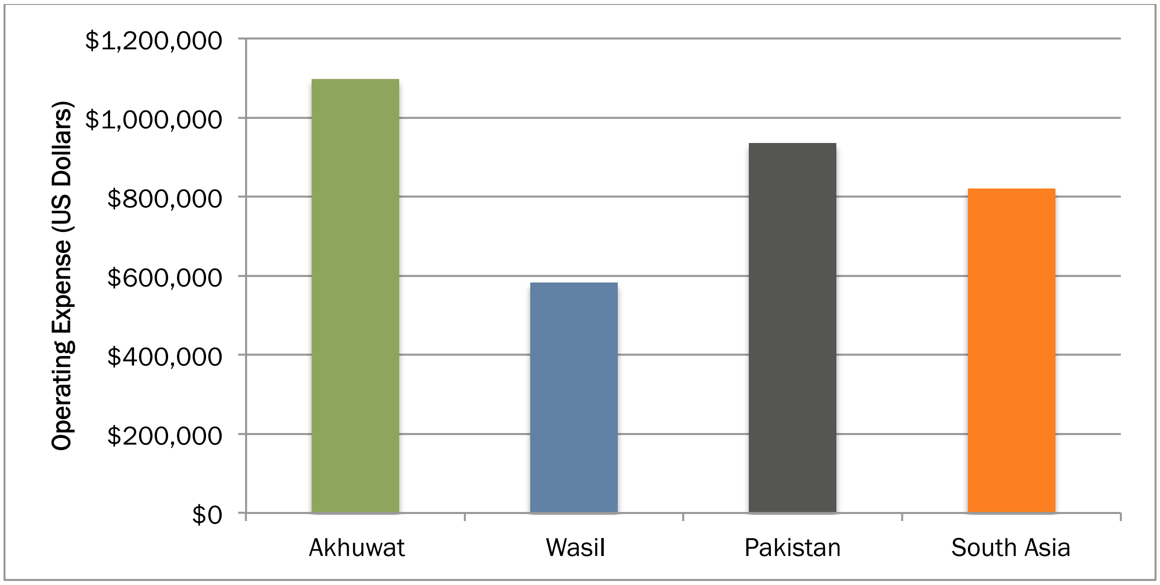
First, let's start with a basic summary of the main differences between Akhuwat and Wasil. In terms of outreach, in 2011 Wasil had 7,257 active borrowers and Akhuwat had a much larger portfolio 63,085 of active borrowers.[10] In 2011, Akhuwat had a gross loan portfolio of $8,059,842 while Wasil had a smaller loan portfolio of $1,390,904. 2011 Financial revenue was $487,287 for Wasil and $921,849 for Akhuwat. It is surprising that Akhuwat's revenue is almost double that of Wasil considering Wasil's much more

[10] While 2011 was the most current year with available numbers for *both* Akhuwat and Wasil, there are more recent individual statistics available on Mix Market that provide valuable insight of Akhuwat's growth. As of 2013, Akhuwat's portfolio of active borrowers totaled a much higher 235, 517 while in 2014 Wasil's portfolio of active borrowers reported in at a 5,482.

diverse portfolio of profit earning services. Taking a closer look at the statistics, we see that Wasil is actually earning a much larger percentage of their revenue from loans, at \$437,844 as opposed to Akhuwat's \$82,669. Akhuwat's financial revenue from loans consists of the upfront application fee of 100 rupees (approximately 94 cents). This implies that Akhuwat either received a massive donation or this is simply an error. Taking a closer look at Mix Market, we can see that financial revenue of Akhuwat from other years is significantly lower (in 2010 it is \$1,249). Again, we have to assume that this is either an error or the result of a massive donation or drastic change in how donations are recognized. Prior to 2011, Akhuwat's financial revenue is actually consistently lower than Wasil's, which intuitively makes sense based on the differences of their portfolios.

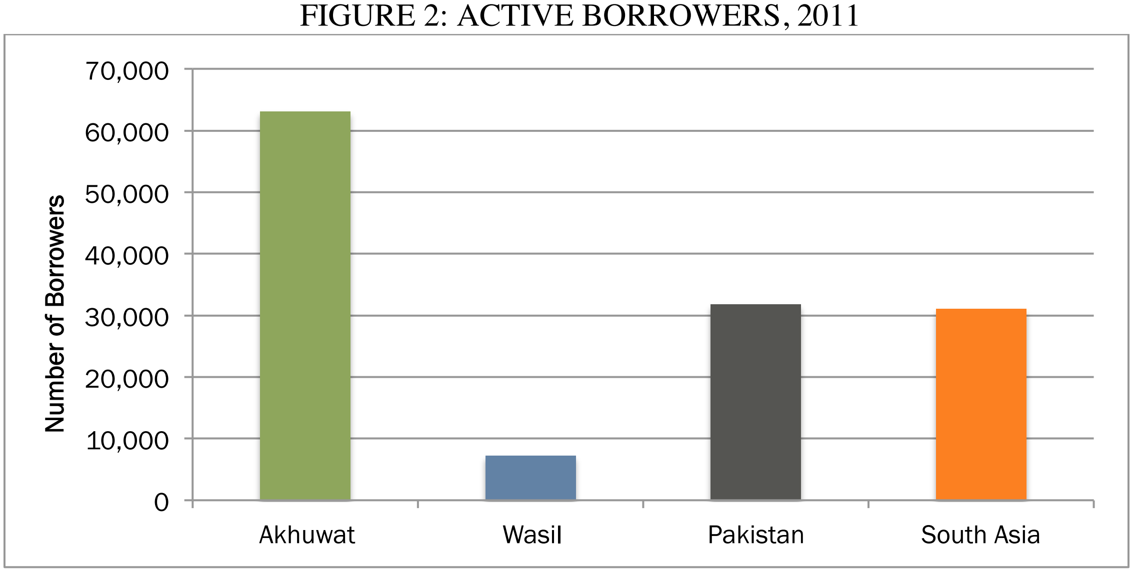
Akhuwat prides itself on its low operational costs and philosophy of maintaining modest office space, salaries, and equipment. They believe low overhead costs and humble conditions are essential if they truly do not intend to profit from their clients. Yet, according to Mix Market, in 2011, Akhuwat's operating expenses totaled \$1,098,747, while Wasil's operating expenses totaled a much lower \$582,050. Figure 1 shows comparisons of operating expenses between Akhuwat, Wasil, the Pakistani median, and the South Asian median.

FIGURE 1: OPERATING EXPENSES, 2011



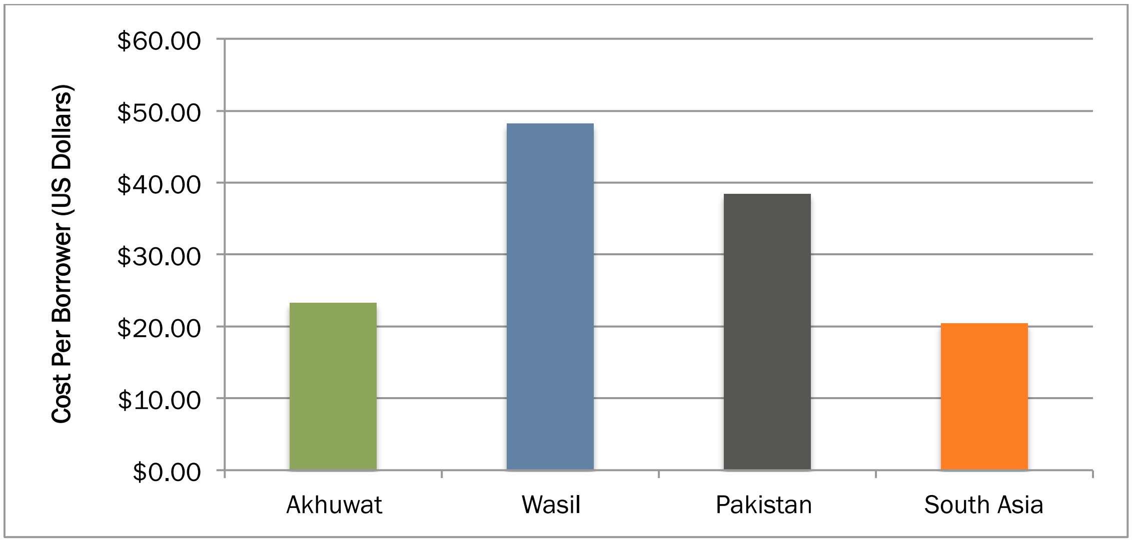
Akhuwat's operating expenses were also higher than the median for all MFIs in Pakistan, as well as the median for all MFIs in South Asia, according to Mix database. However, while Akhuwat's operating expenses are seemingly higher, Akhuwat serves more clients than Wasil and the median Pakistani and South Asian MFI (See Figure 2).

FIGURE 2: ACTIVE BORROWERS, 2011



Thus, a more accurate portrayal of Akhuwat and Wasil's expenses would be using the cost per borrower indicator (operating expense/number of active borrowers). Figure 3 shows the cost per borrower comparisons between Akhuwat, Wasil, the median in Pakistan, and the median in South Asia.

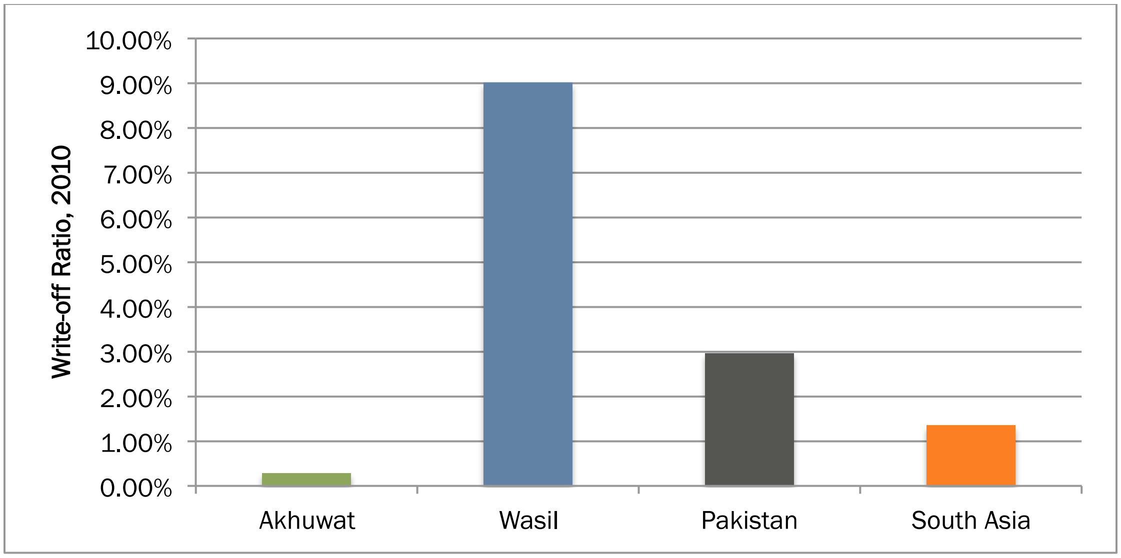
FIGURE 3: COST PER BORRWER, 2011



As shown in Figure 3, the median Cost Per Borrower of MFIs in South Asia is $20.46, with the median cost per borrower of MFIs in Pakistan significantly higher at $38.41. Although slightly higher than the South Asian median, Akhuwat's cost per borrower of $23.29 is efficient in comparison to Wasil and the median Pakistani cost per borrower. However, because Akhuwat touts its low over head costs, modest offices, and partial voluntary staff, Akhuwat should minimize costs to be, at a minimum, at the median South Asian level, if not below.

In addition to touting low operational costs, Akhuwat has been acclaimed for its low delinquency rates. As mentioned earlier, Akhuwat attributes this to the sense of brotherhood instilled through the close-knit community and its strong religious affiliation. The cross-market comparison of Figure 4 uses numbers from 2010 as opposed to 2011 due to missing data.

FIGURE 4: WRITE-OFF RATIO, 2010



As shown in Figure 4, Akhuwat's write-off ratio is impressively low. Although these figures are from 2010, outside sources report that Akhuwat's cumulative recovery as of June 30, 2013 are still very high at 99.87% (2012: 99.86%).[11] The lending scheme of Akhuwat will be further discussed later.

While these commonly used efficiency indicators make for interesting comparisons, assessing sustainability from a self-reported database such as Mix Market is complicated. As discussed earlier, sustainability indicators, such as operational self sufficiency and deficit/surplus are often reliant on figures that may vary drastically depending on accounting standards. On Mix Market, we see incredible volatility in indicators such as Financial Revenue, which can ultimately lead to misleading data summaries. Figures 1 through 3 are likely fairly reliable as they do not involve income calculations, which is where things can get particularly deceptive. While cross-market comparisons from MIX can provide us a general picture of general trends, we need to

[11] Reported by Harper (2011)

take a closer look at the figures provided by official audit reports of Akhuwat to put this picture into focus.

V. Audits: Financial Indicator Clarification

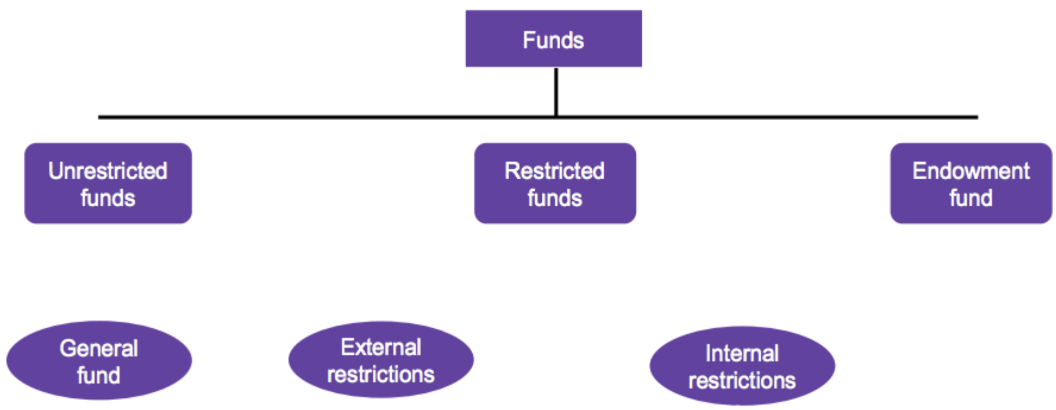
To successfully understand the yearly Surplus and/or Deficits of Akhuwat we must carefully analyze how Akhuwat accounts for their donations. Akhuwat has hired various consulting agencies to do their Audits as of 2008. Deloitte has conducted these reports from the years 2012-2014[12]. Typically on these reports, total income is broken down into operating and non-operating (or other) income. Total income is then divided by expenditure to calculate the deficit or surplus for the year. It is particularly important to note that Akhuwat changed their donation accounting policy in their audit report published for the year ended June 30, 2012. The notes section 22 of the financial statements for year-end June 30, 2012 reads, "During the year, the management has changed the accounting policy for recognition of members' donations. Previously such donations were recognized to Income and Expenditure Account which now has been changed to recognize these donations to "Donated Funds."" The new accounting measures follow the Restricted Fund Method as described by The Institute of Chartered Accountants of Pakistan (ICAP).

Under this method, the organization classifies its restricted operations by fund and recognizes the contributions immediately as revenue of that particular fund. Under the Restricted Fund Method, the organization will also have a general fund, which is

[12] For all Akhuwat Audits, the year-end is June 30th, not January 1st.

composed of non-restricted contributions. In the case of Akhuwat, donations used to cover loans will go now into a Restricted Fund, while donations used to cover operating cost will go into a General Fund. Restricted funds consist of both external and internal restrictions. For example, there may be times when the directors of an organization decide to use certain contributions for certain purpose, and these would fall under the latter type of restriction (See Figure 5).

FIGURE 5: RESTRICTED VERSUS UNRESTRICTED FUNDS



Source: ICAP

This Restricted Fund Method is a widely accepted method. Canadian Non-Profit Accounting Guidelines (CICA) also states that revenue is divided into two funds: an unrestricted fund and a restricted fund. CICA says the following of the restricted fund:

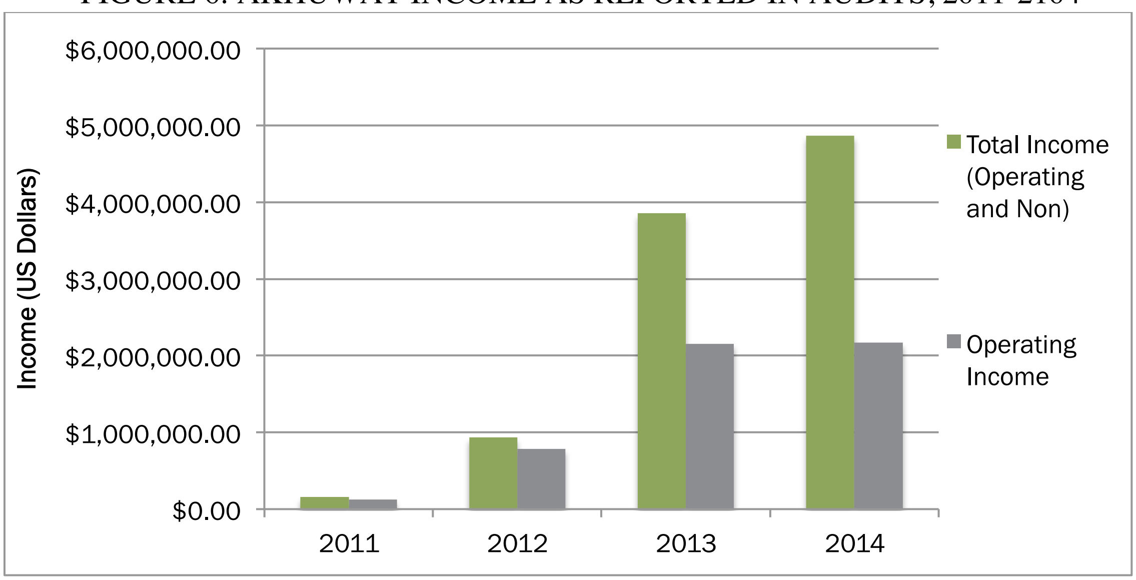
> *Restricted contributions are subject to externally imposed stipulations as to how the funds are to be spent or used. The organization must use the resources in the manner specified by the donor.*

It is important to be aware of the distinction between restricted and unrestricted funds in order to analyze Akhuwat's statements of income and expenditure, and their incurring deficit or surplus. Whether or not Akhuwat includes restricted funds in their total income will have a large impact on the incurring surplus or deficit. To further complicate things, as mentioned, Akhuwat includes two types of donations in Operating Income: Operational Donations and Community Donations. Operational Donations consist of donations given by donors for day to day operational expenses and Community Donations represents donations collected from donation boxes placed at different community centers and retail stores. This is why looking at indicators from databases like Mix Market such as “Revenue,” “Income,” “Net Income,” “Surplus,” and “Profit” may actually be very unreliable. As we shall see, even within the same organization and auditing company, there are fluctuations in income that can be attributed to accounting changes. This does not bode well for the reliability of Mix Market.

In the case of Akhuwat, as of the year ended June 30, 2012, the Restricted fund includes “Donated Funds,” “Contributed Fund,” Takaful Fund,” and a “Rehabilitation Fund.” For example, revenue from the “Takaful Fund” is restricted in the sense that it can only be utilized to subsidize services of Akhuwat Health Clinic and for paying Zakat. Revenue from the “Rehabilitation Fund” is used only for paying stipends to heirs of victims of suicide bomb attacks. While donations received by these funds are considered revenue for each fund, none of these Restricted Funds are included in what Deloitte denotes as Akhuwat’s income for this year. Income, as shown on the Income and Expenditure Account, includes “Processing Fee,” “Other Income,” “Community Donations,” “Operational Donations,” and “Income from AHS Clinic.” It is important to distinguish between donations intended for covering operating costs and donations intended for sustain loan disbursement. Note 4.7 of the audit report states: “Grants received for providing loans are directly recognized in the Donated funds. Other funds provided by the donor to subsidize operating and administrative expenses are recognized directly as income, in the period of receipt." Thus, donations intended for subsidizing operating expenses will be recognized in the General Fund and thus as operating income, while donations intended for loan disbursal will go into the restricted "Donated Fund." Whether or not this "Donated fund" is included in total comprehensive income that goes into calculating the surplus will change over the course of 2012-2014, as we will see below.

First, we will take a look at Akhuwat's Total Income (Operating and non-Operating) in comparison to its Operating Income over the period of 2011-2014.

FIGURE 6: AKHUWAT INCOME AS REPORTED IN AUDITS, 2011-2104

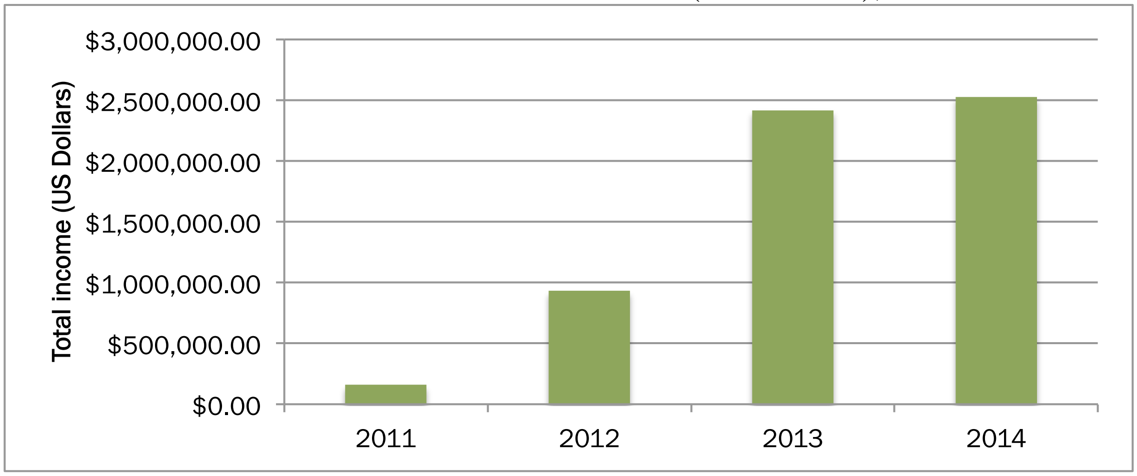


The most obvious thing of interest from Figure 6 is the massive jump from 2012 to 2013 in both Operating and non-Operating Income. These jumps can be attributed partially to changes in funding, but also to changes in accounting. First, we will address the change in accounting by looking at the 2013 figures in the 2014 Deloitte audit. While in the previous audit (year-end June 30, 2013) Total Income comes in at $2,410,263 for 2013, in the 2014 audit Total Income comes in at $3,854,184 for 2013. While Operating Income (including processing fee, community donations, service fee, operational donations, and income from AHS clinic) remains constant for both audits, the 2014 audit report increases the scope of non-operating income in 2013 to include revenue from the restricted "Donated Fund." More specifically, the report includes $1,211,864 from "Donations received during the year," which is the amount of donations received from general public which are used for providing interest free micro loans. Prior to this year, revenue from this restricted fund was not included in total income and consequently not included in total comprehensive income (deficit/surplus). Thus, Figure 6 can be deceptive in that it depicts a massive change in the mechanics of the organization.

The jump in operational income is due to an almost three fold increase in the "service fee," which in this case represents service charges received from Punjab Small Industries Corporation (PSIC) and the Youth Affair Department, both government agencies. PSIC provided an interest free loan of Rs. 2,000 million to be used on a revolving basis to provide interest free micro loans. Akhuwat is entitled to receive service charges of 7% of the disbursed amount from PSIC to meet its operational needs. The jump in Operational Income is also due to an increase in Operational Donations from $123,311 to $488,609.

In order to provide a visual with more consistent comparisons over the course of 2011-2014, the following figure uses income excluding "Donated Funds" across all four years.

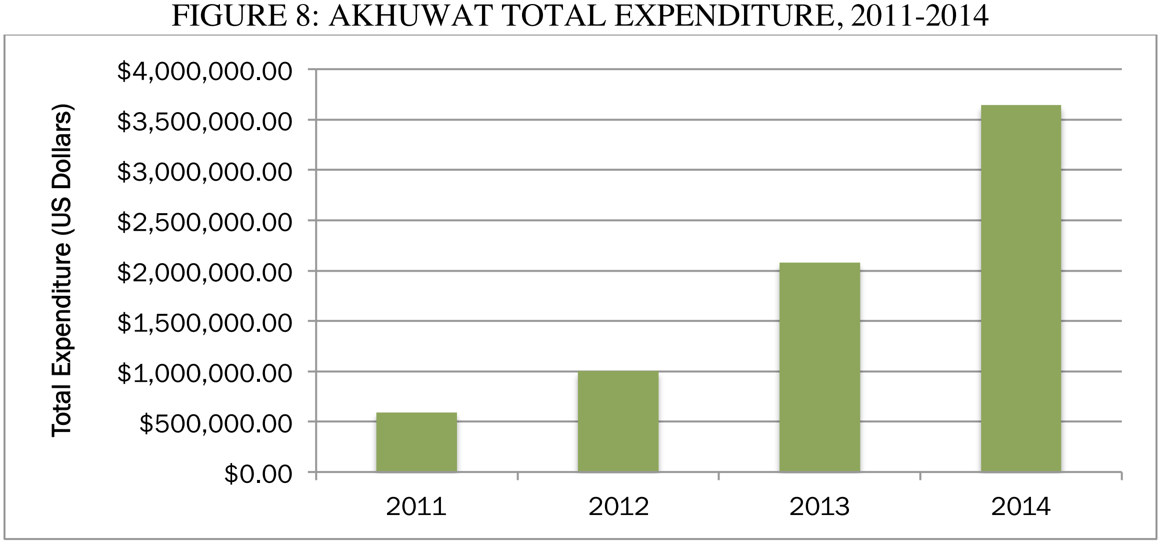
FIGURE 7: AKHUWAT TOTAL INCOME (ADJUSTED), 2011-2014



As shown in Figure 7, there are still notable increases in income from 2012 to 2013 even when excluding donations from members that are streamed into the Restricted Fund. As mentioned earlier, this increase can be attributed to an increase in service fee and operational donations.

Notable increases in income from 2012 to 2013 coincide with significant increases in total expenditure. Fortunately, total expenditure is not affected by changes in donation recognition across the four years, and thus does not need to be adjusted.

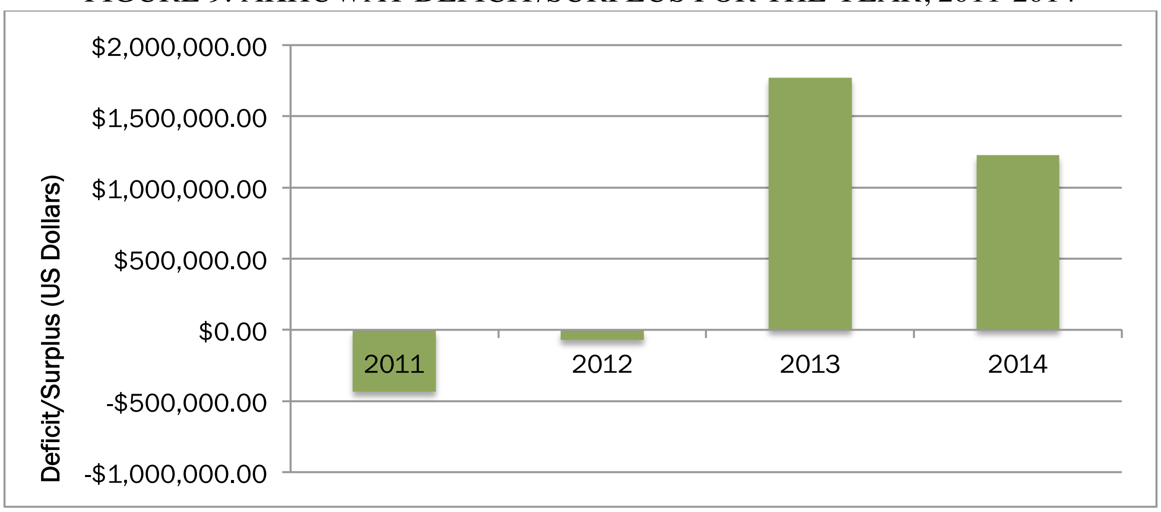
FIGURE 8: AKHUWAT TOTAL EXPENDITURE, 2011-2014



Akhuwat's audit for the year-ended June 30, 2013 shows significant increases in salaries, wages and other benefits from the year 2012 to 2013. In 2012 this category totaled $1,006,258 and in 2013 it increased to $2,082,725. There were also significant increases in Travelling and Conveyance, Rent, Staff Training, and Miscellaneous. This may be an indicator of an expansion including a substantial increase in human capital.

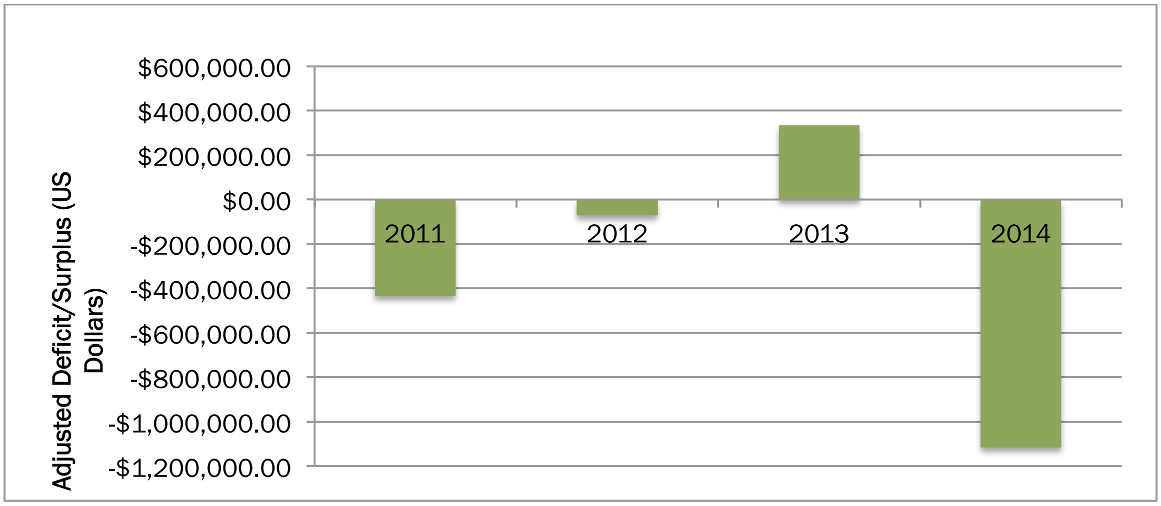
Now that we have taken a look at total expenditure, we can produce two different deficit/surplus graphs, one using the total income and one using the adjusted total income. First we will look at the deficit/surplus graph which one would construct from the figures readily available on Akhuwat's statements of income and expenditure.

FIGURE 9: AKHUWAT DEFICIT/SURPLUS FOR THE YEAR, 2011-2014



This graph bodes well for Akhuwat, showing an impressive transition from a deficit in 2012 to a relatively large surplus in 2013. However, recall that these ratios are based on an inflated income total in 2013 in comparison to past years due to the inclusion of revenue from the restricted funds. Thus, the following figure has been created using consistent calculations for total income. The increase in expenditure from year 2013 to

FIGURE 10: AKHUWAT ADJUSTED DEFICIT/SURPLUS FOR THE YEAR



2014 is realized in Figure 10, which shows that excluding Donated Funds, Akhuwat actually experienced a rather large deficit in 2014. While this is far from a catastrophe, as Akhuwat has seemingly recruited a fairly reliable stream of donor deposits in their restricted revenue, it gives us insight that is impossible to see from Mix Market. Akhuwat should work on minimizing their operating costs by maintaining a hard budget as advised earlier. While Akhuwat's increase in expenditure from 2013 to 2014 may be justified by a possible one-time expansion, it is not matched with significant increase in processing fees over the course of the year. Operating expenses should be checked and if such expenses increase without coinciding increases in operating income, then Akhuwat should undergo severe consequences/changes.

Now that we have clarified various income discrepancies, we can now go on to produce consistent OSS figures. How we define operating income will have significant impact on these figures. It seems most appropriate to abide by The Institute of Chartered Accountants of Pakistan (ICAP) and the Chartered Professional Accountants of Canada (CICA) standards, not only because these are utilized by Deloitte's Audits, but also because they allow for (at least a portion of) donations and subsidies to be included in operating incomes, which is the numerator of OSS. Thus, unlike the total income figure we used to determine the (deficit)/surplus, we will be abiding by OSS formula and including solely Operating Income in the numerator. In a sense, our formulas now capture a hybrid model of OSS by utilizing ICAPs definition of operating income and thus including subsidies.

TABLE 2: OPERATIONAL SELF-SUFFICIENCY OF AKHUWAT, 2011-2014*

2011	OSS= $122,698/$592,030= **.21**
2012	OSS = $788,270/$1,006,258= **.78**
2013	OSS= $2,150,342/ $2,082,725= **1.03**
2014	OSS= $2,166,474/ $3,642,686= **.59**

**In accordance with ICAP's operating income standards*

What is impressive about these numbers is that Akhuwat comes fairly close to reaching full OSS (and does in 2013) without including the substantial revenue accumulated in the Donated funds. There are still donations included in operating income in the form of community and operational donations that are explicitly given with the intention of covering operational costs, but if we were also to include the donations received from ex-borrowers in the OSS formula, Akhuwat will be fully self sufficient. Let's take for example the most recent financial year:

TABLE 3: 2014 ADJUSTED OSS

Year	Adjusted OSS Formula	Adjusted OSS
2014	OSS = Operating Income +Member Donations/ Operating Expenditure +Financial Expenditure	OSS=$2748255/ = **1.3** $2,082,725

We see from Figure 11 that OSS in the year 2014 increased from .59 to 1.3 when the Donated fund was included. If, as discussed earlier in regard to the Return on Assets indicator, we can define donations from ex-borrowers as a legitimate source of financial return on assets, then this Adjusted OSS Formula is actually more representative of Akhuwat's overall financial health.

One of the most commonly cited criticisms of the microfinance industry is the lack of transparency. From the past overview of some of the complications of sustainability indicators, it is clearly understandable why consumers are wary of the self-reported numbers of MFIs as well and the resulting aggregated statistics. The numbers calculated in Figure 10 using the audit report are significantly different than what is shown on Mix Market. On Mix Market, Akhuwat's OSS was .995 in 2011 and .1875 in 2010. In regard to OSS in 2010, we can now revisit with more clarity Dr. Saqib's vague but highly important statement in 2010 that, when including ex-borrower donations, Akhuwat was 60% Operationally Self-Sufficient. In November of 2010, Dr. Saqib stated:

> *It is interesting to note that around sixty percent of our costs are met by donations from our borrowers. We inspire them to donate as much as they want in return for the interest free loan. Without any compulsion or coercion, they are giving donations to meet operational costs; this makes us 60 percent self-sufficient. The way the program is progressing, we believe that in few years, the entire operational cost will be matched by donations given by the borrowers, and we will be operationally self-sufficient.*

From this statement, it is unclear if Dr. Saqib means that donations from borrowers alone makes Akhuwat 60% self-sufficient, or their income statement including donations from borrowers makes them operationally self-sufficient- an important distinction. From the 2010 audit report by A.F. Ferguson & Co., it is clear that Dr. Saqib cannot be referring to the member donations alone covering 60% of operational costs (See Appendix 1). This leaves the alternative of either operating income covering costs or total income covering costs. To add in another confusing layer, operational income is not distinguished from total income in the audit report, so we will have to do some guesswork based on the more resent audit reports from Deloitte. The closest answer we get to Dr. Saqib's estimate based on the audit report is by dividing Operational Income (Total Income-"Other Income," as seen done by subsequent audits).

TABLE 4: Operational Self Sufficiency, 2010

2010	OSS= Operating Income/ Expenditure	OSS= $179,317/$262,925= .**68**

As you may recall from earlier in the section, these calculations are made from the 2010 audit, before changes were made to exclude donations from members from the income statement. So, although Akhuwat has seemingly made little progress on the sustainability from based on OSS indicators since this year, it is at least partially due changes in the recognition of donations.

The discrepancies we see on Mix Market and through the media are indicative of why it is so essential to take a closer look at often-called "opaque" industry and set the record straight. While Akhuwat can clearly stretch their accounting data to manipulate their OSS, which MFIs may have already been doing on Mix Market, this should neither be the goal of the organization or the point of this study. On the contrary, an organization such as Akhuwat should not have to prove itself as financially sustainable, at least in its traditional sense. As Benedetto and Bengo write, "[Akhuwat] reaches financial sustainability in an innovative manner: transforming ex-borrowers into donors…".

VI. Lending Methodology and Gender Dynamics

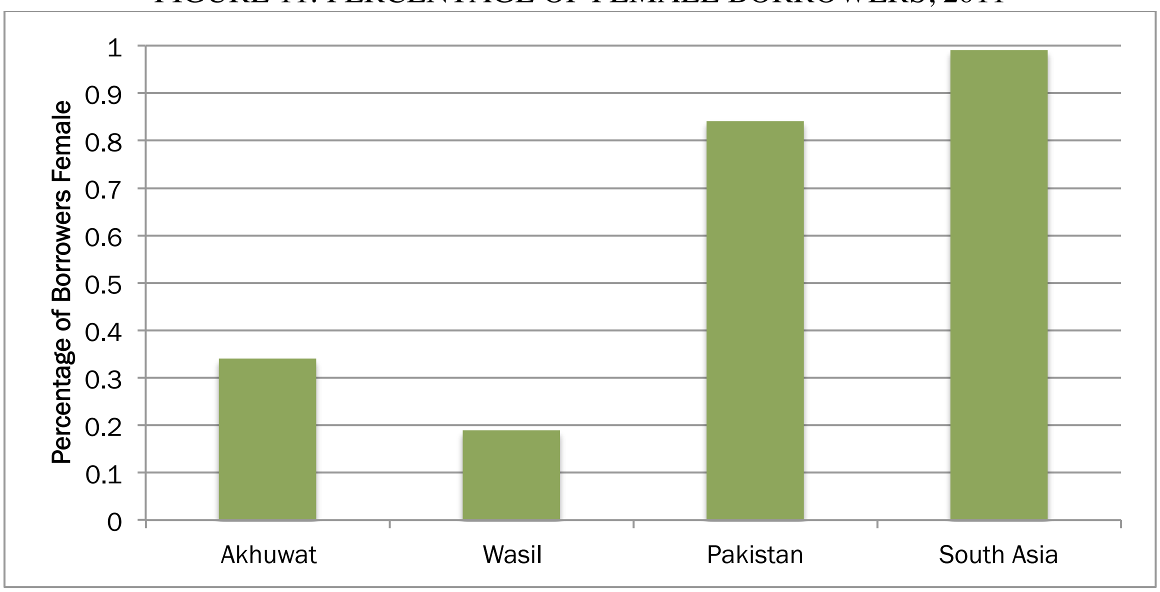
A key sustainability consideration of Akhuwat is the lending scheme. In Akhuwat's initial years, it utilized the group-lending scheme popularized by long standing organizations such as Grameen Bank. However, Akhuwat phased out the group loan strategy as of 2006 because group leaders were found to manipulate position and extort money. According to Akhuwat's Decade Report, "Most group members were selected on the basis of their popularity in the locality and not on their genuine need for credit" (Akhuwat 2010). Further, members complained that the regular group meetings were taking up too much time and the poorest of the poor found it difficult to form or join a group. Others complained that they simply did not want to work in groups; that they were individualist by nature and wanted the same accountability that better-off people received from big banks. Akhuwat was aware that they could use the individual lending as a 'selling point' to attract new clients. Despite international experience, which shows that group loans are more likely to be repaid on time than loans to individuals, Akhuwat's "individual household borrower", also known as its "family loan" model, has higher repayment rates than the prior method (Harper 2011). The table below shows differences in repayment rates between the two schemes, as cited by Harper:

TABLE 5: REPAYMENT RATE BY LENDING SCHEME

Lending Scheme	**Average Repayment Rate**
All Schemes	99.7 %
Group Loans	98.8%
Individual Household Borrower	99.9%

Akhuwat's reasoning for transitioning to family/individual loans also had to do with problematic gender dynamics resulting from prior MFI's experiences. Akhuwat believes that the prevailing emphasis of lending to women has led men to feel inferior and marginalized, thus prompting an increase in domestic violence towards women. According to evidence from Bangladesh, domestic violence was often severe; there were numerous accounts of men throwing acid and disfiguring women's faces (Harper 2011). This is one of the reasons that Akhuwat places much less emphasis on lending to females compared to other MFIS. Figure 11 shows that according to 2011 Mix Market data, females made up only around 30% of Akhuwat's total borrowers.

FIGURE 11: PERCENTAGE OF FEMALE BORROWERS, 2011



As opposed to the widely accepted MFI practice of loaning mainly to women, Akhuwat started experimenting with a family loan model, in order to "strengthen family relationships rather than to promote conflict. " Akhuwat found that staff had to spend less time on each loan, as they only had to visit the applicant to check on his or her income level and reputation in the community (Harper 2011). Harper explains the family lending model:

> *Wives and husbands were required to sign loan agreements, or mothers and sons, or fathers and daughters, and the loans were known as family loans. Every member of the family knows that they have taken a loan, and this creates a sense of unity in the household and avoids duplication of loans in the same family. The entire family is the guarantor and the beneficiary. Borrowers are also required to bring two other guarantors, who are not from the same household, to co-sign their loans, in order to replace the group guarantee. These guarantors do not have to be any wealthier than the people whose loans they are guaranteeing; they have merely to be respectable people in the same communities who know the applicants well and are prepared to stand behind them.*

Once the loan is disbursed, the Unit Manager monitors the client with regular visits to his residence and place of work. If the loan is not repaid within the three days of its due date, a Unit Manager will pay a reminder visit to the client. If the repayments are still not made the guarantors are contacted and asked to make the repayment. From the information given, one may be dubious of whether or not this method really facilitates female independence, rather than constraining them through the authority of requiring a male guarantor. The absence of a "mother to daughter" type loan agreement suggests the latter possibility.

A sample list of borrowers received from Akhuwat headquarters was analyzed for the purpose gaining further understanding of the gender dynamics at play with their Family Lending model. The sample cannot be assumed to be a random sample as it is made up of approximately a 50/50 split of men to women, which is far from reflective of the actual ratio of male to female borrowers. The sample list includes the borrower's name, followed by the first (presumably) guarantor's name, their date of birth, the purpose of the loan, the amount, the gender of the borrower, the date of disbursement, and whether or not they donated to Akhuwat. Despite this not being a random sample, there are several noteworthy points we can gather from this document.

First, the majority of guarantors are male- for both female and male borrowers. Of the female borrowers, at least 70% had male guarantors[13]. Keep in mind that this guarantor is in addition to the family style agreement- likely made between the woman and a male in the family. While the family loan model may have the intentions of reducing male violence towards females and improving family relationships, it seems that using a model solely because it won't disturb preexisting misogynistic family relationships is not progressive. However, the effect of these family dynamics on women's empowerment is beyond the scope or intention of this study, which is to focus on the inner mechanics of the organization.

Regardless of the immeasurability of the women's empowerment effect of the lending scheme, it is impossible to deny quantifiable repayment rates-which are impressive. Akhuwat's unique lending model, as well as its unprecedented low percentage of female borrowers, and most notably its completely interest free product line, defies traditional microfinance trends. As Harper states:

> *It is generally accepted not only that they [MFIs] must be 'sustainable', that is profitable, in order to survive and to attract and retain investors, but that MFIs should lend through some form of group mechanism, that they should lend mainly to women, and they should make rather high charges, not only to be 'sustainable' but also to discourage misuse of loans to encourage repayment and to ensure that their loans are not hijacked by those who are not needy, as so many subsidized goods and services are…Akhuwat is unique because it breaks just about all the generally accepted rules of microfinance, but has nevertheless survived and grown.*

[13] This figure comes from a sample data set of 500 borrowers provided by Akhuwat headquarters. While names of guarantors were provided, genders were not. Hence, guesswork was involved in determining gender and this number is approximate.

While Akhuwat has indeed survived and grown, there is still a need for infrastructural improvement. If a subsidized program such as Akhuwat is to continue at current funding levels, it will also need to continue to find modes of constructive engagement with government owned agencies, as Akhuwat has done with Punjab Small Industries (PSIC). Lessons from past failures suggest that this will require clear understandings of the limits to direct government involvement and a commitment to the transparency and accountability of programs (Morduch 1998).

VII. Opportunities for Infrastructural Change

Opportunities for infrastructural change in Pakistan stem from preexisting income redistribution mechanisms entrenched in Islamic philosophy.[14] Income redistribution is of particular relevance in Pakistan, where 22 % of the population lives in poverty and where income inequality has worsened over the past several decades (Shirazi 2015).

Waqf, the concept of "eternal charity," is derived from the Quran and further developed by Islamic scholars in hadith text. Waqf is a pool of resources created through the accumulation of both financial and real assets. It functions essentially as trust system used for sacrificing one's belongings for the sake of charitable purposes. The welfarist approval of sustainability bodes well for a Waqf-integrated model for Islamic MFIs, particularly for an organization such as Akhuwat.

[14] Mechanisms include the Zakat (an obligatory tax on citizens above a certain wealth level that is redistributed to the poor), Sadaqah (a voluntary charity), Qarz-e-Hassan (interest-free loans), and Waqf (a religious endowment grounded in Islamic law).

First, lets take a closer look at the mechanics and ideology of Waqf. Cash Waqf can either take the form of cash lent for free to the beneficiaries or cash that is invested and then the net return is given to the beneficiaries (Dogarawa 2010). There are typically two allotted uses for Waqf, one for family endowment and another for religious or charitable purposes. The latter one, called Waqf Khairi, will be the one referred to in this paper (Gaudiosi 1988). Waqf is similar to a trust in that property is restricted by guidelines (Ahmad 2007). Like a trustee, the head of the Waqf (known as the Mutawalli) is responsible for running the organization and spends the wealth according to agreed upon rules. Ahmad writes "Countries such as the United States, where trusts are prevalent, have agreed to the fact that Waqf is the best way to transfer income from the rich to the poor. Thus, Waqf and endowments are both used for the same purposes of poverty alleviation and socioeconomic benefits." The concept of Waqf can be distinguished from that of a trust in that the Waqf has to abide by the law of perpetuity- the concept that charitable endeavors should make continual impact over an indefinite period. This is similar to the widely known maxim that we should not simply give a man a fish, but teach him how to fish. To compliment this notion, Waqf funds are meant to strengthen social bonds. The MFI's charitable goals of assisting the poor set up businesses fit well into this framework.

A Waqf-integrated model for Microfinance is particularly well suited for an organization such as Akhuwat. Akhuwat has a simple portfolio consisting of benevolent loans, and thus relies on inexhaustible social investments in charity. Akhuwat's loans are intended for people living well below the poverty line, and, as discussed throughout this paper, the continuation of these loans is reliant on a charitable system. Several studies cite that Waqf could be a potential source of funding Qard-e-Hassan style loans.[15] Further, the welfarist approval of sustainability discussed earlier bodes well for a Waqf-integrated model for Islamic MFIs.

Scholars have laid out some of the problems with the development of the Waqf system in Pakistan. The inability of the government to monitor such institutions and hold them accountable for the funds as well as the potential for religious disagreements on a potential regulatory framework both pose potential challenges. Further, the lack of citizen awareness of the existence of Waqf, and the potential for the Waqf fund to feed into Islamic microfinance doesn't bode well for donations (Shirazi 2015). In fact, according to studies, Pakistanis held negative associations between the correlation of Waqf and microfinance (Shirazi 2015). This means that when asked about the potential use of Waqf both in general and in regard to microfinance, respondents gave negative responses. This negative association is likely due to the lack of knowledge of Waqf and a consequent lack of trust in the potential system. According to the same study, 80% of Pakistani microfinance clients surveyed at random wanted to know more about the Waqf system. It is essential that MFIs build confidence in the eyes of the public in order to build in an infrastructure in which they could tap into these resources (Shirazi 2015). Thus, we revisit the welfarist perspective that relies on the donor as a "social investor" in order to create a sustainable cash flow.

Despite potential obstacles, there is substantial literature that proposes the development of a cash Waqf fund in Pakistan. Kazim and Haider (2012) review Ahmed's "Waqf-based Microfinance: Realizing the Social Role of Islamic Finance" to asses its'

[15] (Kazim 2012), (Shirazi 2015), and (Ahmed 2007) all mention Waqf in connection with Qard-e-Hassan loans

viability in Pakistan. They provide two ways in which the Waqf could be set up. One would be from a state department, where provincial governments could choose to allocate a certain amount of funds to setting up microfinance operations in certain regions. Pakistan has already made movements in this direction. In 1959, the Waqf Properties Ordinance was introduced in order to bring Waqf properties under the control of the state. Waqf properties were traditionally managed by the supposed decedents of the saints of the properties, likely passed down generation to generation. It is of no surprise that income generated by these properties was used for the personal benefit of the owners of these properties. The 1959 Ordinance allows provincial government to oversee Waqf properties falling under their jurisdiction. In the year 2010-2011, the Waqf Board Punjab generated roughly $9,600,160 from these Waqf estates. Of this sum, $10,236 was available for charitable distribution (Kazim and Haider 2012). Unfortunately, microfinance operations would likely face fierce competition in gaining patronage from the State and receiving such funds due to high demand. The second mechanism noted by Kazim and Haider would be to attain Waqf funds directly from the populace. In a sense, Akhuwat is already successfully utilizing this mechanism through their collection of community donations.

VII. Conclusion

Scholars who study MFIs are divided on the topic of sustainability. While “institutionists” believe that MFIs need to be operationally self sufficient without donations and subsidies to be sustainable in the long run, “welfarists” view donors as a reliable source of revenue that can be incorporated in income/expenditure ratios. The logic of institutionists suggests that MFIs need to charge interest rates to cover expenses, thus relying on the assumption that borrowers can afford these high interest rates. However, the most recent studies on Microfinance have come to the conclusion that client over indebtedness is the biggest problem in the industry today.

Welfarists have redefined sustainability as the ability to produce outputs that are valued sufficiently by beneficiaries and other stakeholders so that the program receives enough resources and inputs to continue production. They introduces the concept of a "social investor" and redefine the meaning of "subsidy" so that a donor-funded MFI that has achieved significant outreach and impact such that its social benefits exceed the benefits of alternative social investments should not be considered "subsidized." Based on this theory, we can adjust "operational income" in the OSS formula to include donations. Further, we should not penalize Akhuwat for receiving loans below the market rate by adding this to the "expenses" denominator of the OSS ratio. Based on Akhuwat's most recent audit reports, when donations from ex-borrowers are included in operating revenue for the most recent financial year-end, their OSS ratio is over 1. Under this adjusted formula, Akhuwat should be considered a sustainable model for Islamic interest free Microfinance. Additionally, Akhuwat should tap into Waqf beneficiaries to compliment client donations and create a more reliable stream of revenue.

There are several limitations to these conclusions. As Akhuwat is still relatively young at 12 years in operation, it is hard to predict long run sustainability. The act of clients giving back to Akhuwat is a trend that only started having a significant impact on the organization in 2008, and donation rates have yet to plateau. Further, there are still large variations in Akhuwat's income and expenditures year to year due to growth and capital expenditure. Lastly, there are data inconsistencies across different resources such as Mix Market, Islamic MFI Report, Deloitte, and the Akhuwat Headquarters. Further studies should consider tracking Akhuwat's performance over the next decade. While this paper only addresses sustainability, future research may want to analyze the efficiency and social impact of Akhuwat. Further, because the most recent studies have shown that microfinance can be severely problematic, we should question the prevailing institutionalist guidelines that penalize reliance on donations and subsidies.

Research should focus on identifying the strengths and weaknesses of interest-free and grant giving institutions in comparison to conventional MFIS that provide interest-bearing microloans.

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